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INTERNATIONAL STANDBY PRACTICES (ISP98)

Report of the Secretary-General

1. At its thirty-second session in 1999, the Commission considered, on the basis of a report of the Secretary-General, [1] a request by the Director of the Institute of International Banking Law and Practice, Inc. to consider endorsing for world-wide use the new Rules on International Standby Practices (ISP98) (letter of request of 3 March 1999 is reproduced in annex I). However, owing to the fact that late publication of that report had prevented some delegations from carrying out consultations, the Commission felt obliged to postpone consideration of endorsement until the thirty-third session in 2000.

2. The official text of ISP98 in English, which has been endorsed by the International Chamber of Commerce (ICC) and issued as ICC publication No. 590, is reproduced in annex IV. Translations into Chinese, French, Russian or Spanish are reproduced in annex IV of the respective language versions of this note. Translations into Bulgarian, Hebrew, Korean and Turkish have been prepared and published. Translations into German, Italian, Japanese and Thai are currently being prepared.

3. As stated on the cover of that publication,

> "ISP98 fills an important gap in the market place. Though standby letters of credit have similarities with commercial letters of credit and other financial instruments, there are significant differences in scope and practice. Moreover, it is recognized that the ICC's Uniform Customs and Practice for Documentary Credits (UCP), which is internationally

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1/ A/CN.9/459. The present note largely reproduces A/CN.9/459, since at the thirty-second session of the Commission only the English and the French versions of ISP98 were available.

accepted for commercial letters of credit, is not appropriate for all forms of standbys. A new set of Rules was required for this workhorse of commerce and finance, which, in terms of value, exceeds commercial credits by a ratio of 5:1.

> ISP98 reflects a distillation of practices from a wide range of standby users - bankers, merchants, rating agencies, corporate treasurers, credit managers, government officials and banking regulators. Like the UCP for commercial credits, ISP98 is destined to become the standard for the use of standbys in international transactions."

4. By way of general background, it may be noted that the subject of documentary credits and bank guarantees has been a topic in which the Commission has taken an interest since the time of its inception. The Commission endorsed the 1962 version of the Uniform Customs and Practice for Documentary Credits (UCP) at its second session in 1969, [2] the 1974 version at its eighth session in 1975, [3] the 1983 version at its seventeenth session in 1984 [4] and the 1993 version at its twenty-seventh session in 1994. [5]

5. In view of the close link between ISP98 and the 1995 United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, the Secretary of the Commission participated in the preparation of ISP98 so as to ensure consistency between these two supplementary texts. His prologue to the ICC publication is reproduced in annex III. Additional information on the reasons for the preparation of ISP98 and about its salient features may be deduced from the preface contained in annex II.

2/ Report of the United Nations Commission on International Trade Law on the work of its second session, Official Records of the General Assembly, Twenty-fourth Session, Supplement No. 18 (A/7618), para. 95.

3/ Report of the United Nations Commission on International Trade Law on the work of its eighth session, Official Records of the General Assembly, Thirtieth Session, Supplement No. 17 (A/10017), para. 41.

4/ Report of the United Nations Commission on International Trade Law on the work of its seventeenth session, Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17 (A/39/17), para. 129.

5/ Report of the United Nations Commission on International Trade Law on the work of its twenty-seventh session, Official Records of the General Assembly, Forty-ninth Session, Supplement No. 17 (A/49/17), para. 230.

ANNEX I

Letter of Professor James E. Byrne, Director of the
Institute of International Banking Law and Practice, Inc

I am writing to request endorsement of the International Standby Practices (ISP98) by the United Nations Commission on International Trade Law.

These private rules of practice are intended to apply to standby letters of credit. The idea to prepare such rules was conceived during the deliberations of the UNCITRAL Working Group on International Contract Practices which resulted in the United Nations Convention on Independent Guarantees and Standby Letters of Credit ("the Convention"). These rules were deliberately formulated to complement the Convention whose use is recommended in their Official Preface. The ISP98 drafting process itself was undertaken in regular consultation with the UNCITRAL Secretariat and the Institute has used occasions to promote ISP98 as an opportunity also to promote adoption of the Convention.

ISP98 became effective 1 January 1999. It has been endorsed by the International Financial Services Association and the ICC Commission on Banking Technique and Practice, and issued as ICC publication No. 590. It is currently being used and promoted by major banks which issue standby letters of credit, and is expected to become the world standard within the next few years.

Because of the close links between ISP98 and the Convention, and due to UNCITRAL's past practice of endorsing similar rules of practice, such as UCP500 and Incoterms1990, the Institute formally requests that the Commission consider endorsement of ISP98.

ANNEX II

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Approved by the International Financial Services Association and the ICC Banking Commission

PREFACE

The International Standby Practices (ISP98) reflects generally accepted practice, custom, and usage of standby letters of credit. It provides separate rules for standby letters of credit in the same sense that the Uniform Customs and Practice for Documentary Credits (UCP) and the Uniform Rules for Demand Guarantees (URDG) do for commercial letters of credit and independent bank guarantees.

The formulation of standby letter of credit practices in separate rules evidences the maturity and importance of this financial product. The amounts outstanding of standbys greatly exceed the outstanding amounts of commercial letters of credit. While the standby is associated with the United States where it originated and where it is most widely used, it is truly an international product. Non-U.S. bank outstandings have exceeded those of U.S. banks in the United States alone. Moreover, the standby is used increasingly throughout the world.

Standbys are issued to support payment, when due or after default, of obligations based on money loaned or advanced, or upon the occurrence or non-occurrence of another contingency.

For convenience, standbys are commonly classified descriptively (and without operative significance in the application of these Rules) based on their function in the underlying transaction or other factors not necessarily related to the terms and conditions of the standby itself. For example:

A "Performance Standby" supports an obligation to perform other than to pay money, including for the purpose of covering losses arising from a default of the applicant in completion of the underlying transactions.

An "Advance Payment Standby" supports an obligation to account for an advance payment made by the beneficiary to the applicant.

A "Bid Bond/Tender Bond Standby" supports an obligation of the applicant to execute a contract if the applicant is awarded a bid.

A "Counter Standby" supports the issuance of a separate standby or other undertaking by the beneficiary of the counter standby.

A "Financial Standby" supports an obligation to pay money, including any instrument evidencing an obligation to repay borrowed money.

A "Direct Pay" Standby supports payment when due of an underlying payment obligation typically in connection with a financial standby without regard to a default.

An "Insurance Standby" supports an insurance or reinsurance obligation of the applicant.

A "Commercial Standby" supports the obligations of an applicant to pay for goods or services in the event of non-payment by other methods.

In the past, many standbys have been issued subject to the UCP even though it was intended for commercial letters of credit. The UCP reinforced the independence and documentary character of the standby. It also provided standards for examination and notice of dishonor and a basis to resist market pressures to embrace troublesome practices such as the issuance of standbys without expiration dates.

Despite these important contributions, it has long been apparent that the UCP was not fully applicable nor appropriate for standbys, as is recognized in UCP 500 Article 1 which provides that it applies "to the extent to which they may be applicable." Even the least complex standbys (those calling for presentation of a draft only) pose problems not addressed by the UCP. More complex standbys (those involving longer terms or automatic extensions, transfer on demand, requests that the beneficiary issue its own undertaking to another, and the like) require more specialized rules of practice. The ISP fills these needs.

The ISP differs from the UCP in style and approach because it must receive acceptance not only from bankers and merchants, but also from a broader range of those actively involved in standby law and practice---corporate treasurers and credit managers, rating agencies, government agencies and regulators, and indenture trustees as well as their counsel. Because standbys are often intended to be available in the event of disputes or applicant insolvency, their texts are subject to a degree of scrutiny not encountered in the commercial letter of credit context. As a result, the ISP is also written to provide guidance to lawyers and judges in the interpretation of standby practice.

Differences in substance result either from different practices, different problems, or the need for more precision. In addition, the ISP proposes basic definitions should the standby permit or require presentation of documents by electronic means. Since standbys infrequently require presentation of negotiable documents, standby practice is currently more conducive to electronic presentations, and the ISP provides definitions and rules encouraging such presentations. The development of S.W.I.F.T. message types for the ISP is anticipated.

The ISP, like the UCP for commercial letters of credit, simplifies, standardizes, and streamlines the drafting of standbys, and provides clear and widely accepted answers to common problems. There are basic similarities with the UCP because standby and commercial practices are fundamentally the same. Even where the rules overlap, however, the ISP is more precise, stating the intent implied in the UCP rule, in order to make the standby more dependable when a drawing or honor is questioned.

Like the UCP and the URDG, the ISP will apply to any independent undertaking issued subject to it. This approach avoids the impractical and often impossible task of identifying and distinguishing standbys from independent guarantees and, in many cases, commercial letters of credit. The choice of which set of

rules to select is, therefore, left to the parties--as it should be. One may well choose to use the ISP for certain types of standbys, the UCP for others, and the URDG for still others. While the ISP is not intended to be used for dependent undertakings such as accessory guarantees and insurance contracts, it may be useful in some situations in indicating that a particular undertaking which might otherwise be treated as dependent under local law is intended to be independent.

For the ISP to apply to a standby, an undertaking should be made subject to these Rules by including language such as (but not limited to):

This undertaking is issued subject to the International Standby Practices 1998.

or

Subject to ISP98.

Although the ISP can be varied by the text of a standby, it provides neutral rules acceptable in the majority of situations and a useful starting point for negotiations in other situations. It will save parties (including banks that issue, confirm, or are beneficiaries of standbys) considerable time and expense in negotiating and drafting standby terms.

The ISP is designed to be compatible with the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (which represents a useful and practical formulation of basic standby and independent guarantee law) and also with local law, whether statutory or judicial, and to embody standby letter of credit practice under that law. If these rules conflict with mandatory law on issues such as assignment of proceeds or transfer by operation of law, applicable law will, of course, control. Nonetheless, most of these issues are rarely addressed by local law and progressive commercial law will often look to the practice as recorded in the ISP for guidance in such situations, especially with respect to cross border undertakings. As a result, it is expected that the ISP will complement local law rather than conflict with it.

The ISP is intended to be used also in arbitration as well as judicial proceedings (such as the expert based letter of credit arbitration system developed by the International Center for Letter of Credit Arbitration (ICLOCA) Rules or general commercial ICC arbitration) or with alternative methods of dispute resolution. Such a choice should be made expressly and with appropriate detail. At a minimum, it can be made in connection with the clause relating to ISP98 - e.g. This undertaking is issued subject to ISP98, and all disputes arising out of it or related to it are subject to arbitration under ICLOCA Rules (1996).

Although translations of the ISP into other languages are envisioned and will be monitored for integrity, the English text is the official text of the ISP in the event of disputes.

The ISP is the product of the work of the ISP Working Group under the auspices of the Institute of International Banking Law & Practice, Inc. which interacted with hundreds of persons over a five year period, and has benefitted from comments received from individuals, banks, and national and international associations. In particular, the participation of the International Financial Services Association (formerly

the USCIB) and the Ad Hoc Working Group under the chairmanship of Gary Collyer (which led to its endorsement by the ICC Banking Commission) is gratefully recognized. In addition, the sponsorship and support of Citibank N.A., The Chase Manhattan Bank, ABN-AMRO, Baker & McKenzie, and the National Law Center for Inter-American Free Trade is acknowledged. Perhaps the greatest significance of the ISP is that its creation marks a new chapter in the collaboration between the international banking operations community and the legal community at an international level. In this respect, the active role played in this process by the Secretariat of the United Nations Commission on International Trade Law has been invaluable.

The ISP is drafted as a set of rules intended for use in daily practice. It is not intended to provide introductory information on standbys and their uses. While it is recognized that specific rules would benefit from explanatory comments, such comments are not appended to the ISP because the resulting work would be too cumbersome for daily use. Instead, introductory materials and Official Comments are available in the *Official Commentary on the International Standby Practices (ISP98)*. For further information on support materials and developments on the ISP and to pose queries, consult the ISP98 website: www.ISP98.com.

To address inevitable questions, to provide for official interpretation of the rules, and to assure their proper evolution, the Institute of International Banking Law & Practice, Inc. has created a Council on International Standby Practices which is representative of the several constituencies which have contributed to the ISP and has charged it with the task of maintaining the integrity of the ISP in cooperation with the Institute, the ICC Banking Commission, the IFSA, and various supporting organizations.

James G. Barnes
Baker & McKenzie
Vice Chair
ISP Working Group

Professor James E. Byrne
Director,
Institute of International Banking
Law & Practice, Inc.
Chair & Reporter
ISP Working Group

Gary W. Collyer
Chair, ICC Ad Hoc Working Group &
Technical Adviser to the
ICC Banking Commission

ANNEX III

PROLOGUE

by Gerold Herrmann, Secretary
United Nations Commission on International Trade Law (UNCITRAL)

It was an extremely interesting and enriching experience for me to assist in drafting ISP98. This participation allowed me to witness (and now bear witness to) the very thorough and pragmatic drafting process in a superbly selected group, with representatives of all interested sectors actively involved in standby letter of credit practice such as: bankers, especially those responsible for letter of credit operations and global trade transactions, bank counsel, attorneys, academics, regulators, government officials, corporate treasurers, and likely influential beneficiaries. The treasure trove of experience and expertise and the diversity of interests and perspectives proved invaluable in determining--as was continuously done by examining concrete practical examples--whether on a given issue an operational rule would be desirable and useful and, if so, which solution would work best and reflect good practice.

Continued participation in the preparatory work has also convinced me--as, I am sure, it would have anyone else--of the special characteristics of standbys at the operational level of practical detail and usage. Their special features, in my view, not only justify but also necessitate special contractual rules designed for standbys. As the constant comparison with the UCP clearly revealed, quite a few UCP Articles are inappropriate for standbys and quite a few issues of paramount importance in standby practice are not addressed at all in the UCP. While a similar disparity in practice exists between the standby and the independent guarantee (the bank or demand guarantee European style), this seems particularly, if not exclusively, true for those types of actual use (e.g. financial standby, direct-pay standby) hitherto found only extremely rarely in guarantee practice. For this and other reasons, including firmness of the undertaking, I would not be surprised to see not only standbys but also some demand guarantees issued subject to ISP98.

For a professional unifier of law, participation in the preparatory work was particularly satisfying because of its interconnection with other harmonisation and reform efforts. In addition to the concordance with revised Article 5 UCC (the letter-of-credit law of the homeland of the standby) and the similarly close contact (and personal overlap) with the 1993 UCP revision task force, I am referring in particular to UNCITRALs work which culminated in the adoption in 1995 by the General Assembly of the "United Nations Convention on Independent Guarantees and Stand-by Letters of Credit." The idea of preparing special operational rules for standbys was born during the extensive debates comparing national laws as well as the two instruments to be married by that Convention. Since bride and groom were presented there in all facets and critically scrutinized by their future in-laws, UNCITRALs *travaux preparatoires* make for highly informative reading (as will future abstracts of court decisions to be published in UNCITRAL's case collection system called CLOUT; homepage: www.un.or.at/uncitral). It was gratifying to see the group preparing ISP98 refer continuously to the UNCITRAL Convention in order to ensure complete consistency. I must admit to special gratification by overhearing one of the world's leading letter of credit expert's remark to his banking colleague: "The more I look at this UN Convention, the more I really like it."

The above coordination or cooperation in the universal harmonisation and modernization efforts is welcome and in fact crucial because of the (often neglected or ignored) interdependence between the two very different levels of legal norms: the contractual level, where such sets of rules like ISP98, UCP 500, or URDG become effective by agreement of the individual parties, and the statutory level, where internationally elaborated law like the UN Convention or domestic law (e.g. Art. 5 UCC) recognise and give full effect to the exercise of that party autonomy and regulate certain issues that can effectively be settled only at that level (e.g. standards of fraud exception, injunctive relief and other court matters). Therefore, ISP98 and the Convention supplement each other in an ideal manner and together lay the necessary basis for a smooth functioning of standby practice worldwide.

ANNEX IV

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International Chamber of Commerce (ICC)
ICC Publishing SA
38, Cours Albert 1er
75008 Paris, France
Tel. (+33-1) 49 53 29 56
Fax. (+33-1) 49 53 29 02
Internet: http://www.iccbooks.com

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